

DRAFT

NORTH CAROLINA SUPPLEMENTAL RETIREMENT BOARD OF TRUSTEES

MINUTES OF MEETING

December 11, 2014

Time and Location: The North Carolina Supplemental Retirement Board of Trustees (the “Board”) met at 9 a.m. on Thursday, December 11, 2014, in the Caswell Building, 200 W. Jones Street, Raleigh, North Carolina.

Members Present: The following members were present: Treasurer Janet Cowell, Melinda Baran, Karin Cochran, Walter Gray, Gene Hamilton, Michael Lewis, Keith Burns, and Ron Stell. Robert Orr attended via telephone.

Staff Present: The following Department of State Treasurer staff were present: Melissa Waller, Steve Toole, Mary Buonfiglio, Mary Laurie Cece, Maja Moseley, Rekha Krishnan, Rosita Sabrosso-Rennick, Erica Hinton, Koreen Billman, Lisa Page, Jaclyn Goldsmith, Arlene Jones-McCalla, Tim Viezer, and Kevin SigRist.

Guests Present: The following guests attended the meeting: From Mercer: Liana Magner and Kelly Henson. From Prudential: Michael McCann, Ann Cashman, Robert Luciani, Tom Conlon, and Kathleen Neville. Jessica Quimby attended via telephone. From TIAA-CREF: Bruce Corcoran, James Summerlin, Debbie Bell, and Jim Simone. From Aon-Hewitt: Caroline Husa. From Southern Strategy Group: Scott Laster.

AGENDA ITEM – WELCOME AND INTRODUCTIONS

The meeting was called to order at approximately 9:05 a.m. Melissa Waller, acting chair, welcomed board members, staff, and guests. She informed everyone that the Treasurer had another engagement and would be joining the meeting later.

AGENDA ITEM – ETHICS AWARENESS AND IDENTIFICATION OF CONFLICTS OR POTENTIAL CONFLICTS OF INTEREST

Ms. Waller asked board members to review the agenda for the meeting and identify any actual, implied, or potential conflicts of interest. Ms. Cochran noted that her husband works for Verity, a potential competitor of TIAA, but did not feel there was any conflict. There were no other conflicts identified.

AGENDA ITEM – APPROVAL OF MINUTES

Ms. Waller asked if there were any comments regarding the minutes of the September 11, 2014, board meeting. There were no comments. Ms. Baran made a motion that the minutes be approved. Mr. Burns seconded, and the motion passed unanimously.

AGENDA ITEM – APPROVAL OF MINUTES

Ms. Waller asked if there were any comments regarding the minutes of the November 12, 2014, special board meeting. There were no comments. Ms. Baran made a motion that the minutes be approved. Ms. Cochran seconded, and the motion passed unanimously.

AGENDA ITEM – BUDGET UPDATE

Ms. Waller recognized Mr. Steve Toole to discuss the budget update. Mr. Toole pointed out that Slocum was engaged to evaluate the Investment Consultant structure, and that the Department of State Treasurer (DST) was able to negotiate their service fee down to \$110,000. Mr. Burns asked about the Annual Benefits Statement (ABS) budget item, and remarked that it reflects 10 percent of the budget. He also asked whether more information can be delivered electronically. Mr. Toole confirmed that ABS statements are available online as pdf documents in ORBIT. Mr. Toole added that an enhancement is planned for the ABS so that it will be able to capture all outside assets. He noted that the goal of the ABS is to show a holistic retirement readiness picture. The budget item is for these enhancements and IT work. He indicated that he is not sure if it will all be spent.

Ms. Cochran asked if some of the initiatives planned for 2015 are driven by the potential to lower costs. Mr. Toole replied that the goal of retirement readiness is the driver behind those initiatives. Ms. Cochran asked about the budget item entitled, “Miscellaneous Contractual Services,” and whether this would fluctuate. Mr. Toole noted that most service agreements are all in services, but this item is in the budget in case some extra unexpected services are needed. Ms. Buonfiglio noted that a project manager for the marketing RFP would fall under this category.

AGENDA ITEM - SUPPLEMENTAL RETIREMENT PLANS KEY METRICS

Ms. Waller recognized Ms. Buonfiglio to report on the Supplemental Plans’ key performance metrics. Ms. Buonfiglio stated this is a new report, and the objective is to capture and consolidate the relevant data on the plans’ performance in one presentation. Ms. Buonfiglio began with the description of the retirement readiness goals, and pointed out that nearly 68 percent of

participants are on track to replace 80 percent of their income in retirement; retirement readiness goals for year 2014 and 2020 are 70 percent and 90 percent, respectively. With regard to plan participation levels, approximately 30 percent of eligible employees participate in the NC 401(k) and/or the NC 457(b) Plans; the NC 403(b) Program is in the start-up phase, and the goal is 3 percent participation by the end of 2015. The NC 403(b) Program has already exceeded its monthly dollar contribution goal of \$140 due to early adoption rates by school district executives.

Ms. Buonfiglio also discussed that Prudential is tracking GoalMaker participation across the NC 401(k) and NC 457(b) Plans, and TIAA is looking at how target date funds are being used in the NC 403(b) Program. This helps us see how these asset allocations tools are being used. Within the NC 403(b) Program, the 2015 goal is 90 percent utilization of target date funds for new contributions. Ms. Buonfiglio noted that robust counseling sessions are a great way to help achieve appropriate portfolio allocation. A goal of 1,500 distinct counseling sessions has been set. Ms. Baran asked about participation rates in the supplemental plans overall. Ms. Buonfiglio replied that the level of participation is about 30 percent, which is consistent with other state plans that also have a DB plan and which do not offer auto-enrollment. She noted that once auto-enrollment is introduced, however, participation rates typically jump to between 80-90 percent. Ms. Baran asked how the auto-enrollment proposal would be received by the legislature. Mr. Toole replied that while the proposal has not been publicized yet, the Office of State Human Resources is supportive of the idea.

Mr. Orr asked about contribution levels with auto-enrollment and how they would be set. Mr. Toole stated that auto-escalation is key in auto-enrollment introduction, and that the lower salaries of public servants must be balanced with economic need when determining default amounts. Mr. Toole said that a proposed contribution level will be presented at the next board meeting. Mr. Hamilton asked whether the NC 403(b) monthly contribution goal of \$140 was based on income percentage. Mr. Grey suggested that contribution levels might be measured as a percentage of income rather than a dollar amount. Ms. Baran stated that every person should be saving 20 percent of their gross income, and putting 6.35 percent aside for retirement, which could be done with the aid of supplemental retirement plans. Ms. Buonfiglio discussed the addition of a “trend” column to the report. Mr. Burns noted that perhaps different nomenclature should be used, as this is not showing a change from one specific period of time to another. Ms. Buonfiglio agreed. Mr. Hamilton asked why so many more participants entered the NC 401(k) than the NC 457(b). Mr. McCann explained that the NC 401(k) has a longer legacy, and that there was a slower rate of adoption of the NC 457(b). He did point out that since Prudential took over the NC 457(b) Plan that there has been a higher rate of adoption, and they are trying to educate participants of the features of the NC 457(b) as compared to the NC 401(k). He also noted that some of the local entities have chosen an NC 457(b) sponsored by another entity and not the state.

Ms. Buonfiglio went on to describe the results of the recordkeeper satisfaction survey received

from participating employers: 85.16% of respondents rated their satisfaction level with Prudential's service as "satisfied" or "extremely satisfied"; among the participants, 73.7% were satisfied or very satisfied. In the 403(b) plan, preliminary data shows 93% satisfaction rate, which exceeds the goal set at 91%.

Ms. Buonfiglio stated that this report is to give a snapshot of lan performance, and that the document will evolve as other suggestions and comments are received. Ms. Cochran suggested that board members employed with the state might want to talk to members within their agencies to help drive participation.

AGENDA ITEM – INVESTMENT CONSULTANT STRUCTURE

Mr. Toole stated the project to determine the future investment consultant structure (ERISA style 3(38) vs. 3(21) structure) for the supplemental plans had begun with Slocum as the project's outside consultant. The project team will include members of IMD, legal, Office of State Treasurer, and RSD. Mr. Toole said that if any board members wanted to be part of the project team, to please let him know. He noted that this is only for the NC 401(k) and NC 457(b) Plans; investment decisions on the NC 403(b) Program will be retained by the program sponsor. Mr. Toole gave the following project schedule overview:

- An initial due diligence meeting will take place during the third week of December, 2014; evaluation of current cost structure and staffing will take place mid-January, 2015; risk assessment will also take place at this time.
- Project status re-check will take place mid-February, 2015: Slocum will evaluate all possible delegation models and make their recommendation.
- A final recommendation will be made to the board during March, 2015 meeting.

AGENDA ITEM – BEST BOARD PRACTICES

Ms. Waller gave a report on board best practices initiatives occurring across all DST boards. She stated that all the boards will go through self-assessments, as well as assessments of the executive directors. These assessments will look at a range of things from board book preparation to communication with board members. One of the objectives is to learn about board interactions and how they influence decisions. Ms. Waller noted that the State Health Plan, as well as Investment Management Division, has already taken part in the self-assessments, and the Supplemental Board is scheduled for some time in 2015.

Ms. Cochran asked why an external, formal assessment needed to be performed, rather just an internal assessment. Ms. Waller replied that a third-party consultant offers more distance regarding certain issues, and that it is helpful to have the expertise of someone who has experience with other boards. She noted that DST continues to do internal assessments. A good example of this is the creation of the dashboard report just presented by Ms. Buonfiglio. This was done as the result of an internal recommendation. Ms. Waller asked the members to continue

submitting suggestions to identify trends for improvement.

AGENDA ITEM – LEGISLATIVE UPDATES

Mr. Toole gave an update on legislative initiatives. The three main initiatives planned for 2015 for the Supplemental Plans are extension of board terms, auto-enrollment/auto-escalation, and NC 403(b) adoption by community colleges.

The current board term is two years, and there is a proposal for a new term of three years with a maximum of two consecutive terms. Existing member terms would be renewed at three years, and all new members would serve a -threeyear term. Mr. Burns pointed out that we need to be mindful of the transition period and not overextend the term to seven years.

The auto-enrollment and auto-escalation proposal will be adopted for state agencies; local plans will be able to choose their option. The default plan for this proposal is the NC 457(b) Plan. Whether or not to do it in the NC 403(b) is still being discussed. Mr. Toole stated that he thinks auto-enrollment and auto-escalation should be introduced together, not separate. Mr. Hamilton asked about the opt-out feature, and Mr. Toole confirmed it would be made available to those who were auto-enrolled. Mr. Lewis asked about the auto-enrollment dollar rate, and Mr. Toole clarified the rate would be a set percentage, based on overall salary levels statewide. Mr. Toole said that once the savings start accumulating, participants will hopefully understand and appreciate the process better. Mr. Orr asked whether the current legislative body would be receptive to such a proposal. Mr. Toole stated that legislators are looking for a detailed proposal. He thought there was some resistance to the initial proposal; however, the current proposal has the support of the OSHR director, who indicated that the Governor may be supportive, as well. Mr. Toole added that an ad hoc board meeting may be called during this time to aid the proposal. Mr. Lewis asked about possible arguments against the proposal, and Mr. Toole replied that the impact of yet another deduction from already-low state salaries is one possible argument. Mr. Gray asked about existing plan participants, and Mr. Toole said that auto-escalation was being considered for them. Mr. Orr noted that when pay raises are combined with auto-escalations, this has been successful. Mr. Toole stated this is being looked at as well. Next, Mr. Toole described one other piece of legislation proposed that would allow community colleges to participate in the NC 403(b) Program. Ms. Baran asked about the number of potential participants in the community college population. Mr. Toole said he would get this data and report back.

AGENDA ITEM – APPROVAL OF INVESTMENT SUBCOMMITTEE MEETING MINUTES FROM NOVEMBER 13, 2014

Ms. Waller called upon Ms. Baran to give a report from the Investment Subcommittee. Ms. Baran highlighted some of the events of the November 13, 2014, Investment Subcommittee meeting. Galliard is working to reduce the Great West share of the Stable Value Fund to 20 percent. Galliard also reported on a Wells Fargo fee increase for custodial services. Ms. Baran stated that staff is working toward a resolution, as they believe Wells Fargo should not be

charging a custody fee. Galliard is monitoring the PIMCO allocation to make sure any asset outflows by PIMCO are manageable. They also stated they are not putting new clients into PIMCO. Galliard gave an update on the accounts receivable issue. Mr. Buonfiglio added that the audit will be completed and a resolution will be presented to the board in March 2015. Ms. Baran noted the subcommittee had a discussion regarding J.P. Morgan legal issues. She noted that since the meeting, it has come to light that J. P. Morgan is also facing currency trading probes, and could be facing some issues with regard to compliance with capital requirements. Ms. Baran is concerned with a possible impact to the investment management side of the business, and would like to place the item on the February 2015 Investment Subcommittee agenda for Mercer to review. Mr. Burns also requested an explanation on how J.P. Morgan's advisory business is a separate corporate structure, and whether this might minimize the impact to the plans.

Ms. Baran highlighted a few items covered by Mercer in the meeting. With regard to the Investment Policy Statement (IPS), Mercer is proposing a more general IPS, and wants to move away from a manager-specific IPS. Mercer will present recommendations on American Depositary Receipts based on an investment compliance portfolio review. Beginning January 2015, the NC 403(b) Program investment performance review will begin, and a template will be implemented that is consistent with the NC 401(k) and 457(b) Plans.

Ms. Baran made a motion to approve the November 13, 2014, meeting minutes, and the motion was seconded by Ms. Cochran, passing unanimously.

AGENDA ITEM – THIRD QUARTER PERFORMANCE REPORT

Ms. Waller recognized Ms. Liana Magner and Ms. Kelly Henson from Mercer to present the third quarter performance review.

Ms. Magner gave an overview of the U.S. and global market performance for the quarter. She stated the global economic outlook is mixed, but the U.S. economy did better. Business investment remains weak. She stated there was a big disparity in returns based upon where a manager was invested because the sectors varied widely in their performance. Non-U.S. markets were flat and experienced negative returns. Emerging markets were down 3.5 percent due to declining commodities. Long-term bonds outperformed short-term, and the yield curve flattened. Commodities were down 12 percent, and this impacted the Inflation Response Fund. Ms. Magner noted there continues to be a decline in oil and gold prices. Ms. Henson reviewed the investment manager performance scorecard. She noted that Wellington was placed on watch in both Quality Value and Opportunistic Growth funds. This manager will be reviewed in-depth during the Investment Subcommittee meeting in February, 2015, and possible replacement will be considered. She noted that Loomis Sayles was added to replace Neuberger over the summer, and a composite history was used to create their scorecard. Ms. Henson also pointed out that Brown Advisory experienced a significant underperformance, particularly in the second quarter of 2014. Brown is particularly sector-concentrated and, thus, more volatile. She also noted that the Global

Equity Fund was a strong performer for the quarter. Ms. Buonfiglio asked for an update on the PIMCO transition. Ms. Magner stated the transition should be straightforward, as Prudential is the sub-advisor and they have performed their own due diligence. Ms. Buonfiglio noted that Mercer conducted a replacement search for PIMCO, and the Investment Subcommittee based their decision on those search findings. Ms. Cochran asked if it was possible to have some replacement manager alternatives to Wellington and Brown ready for the February Investment Subcommittee meeting. Ms. Magner stated the procedure is that prior to searching for a replacement, the manager should first be placed on watch. Ms. Buonfiglio said there is enough flexibility in the Investment Policy Statement to do a manager search prior to going on the watch list, but she thinks it is preferable to follow the official process. Ms. Henson noted that by the time a manager goes on the official watch list, possible replacement candidates have already been researched, and Mercer can move quickly should the need arise.

Ms. Henson gave an overall review of the plans' fees, and noted that while some individual managers might have a higher fee, the plans are getting compensated in value. Mercer is trying to negotiate a lower fee for the PIMCO Inflation Sensitive Fund. Ms. Henson also presented the detailed fee structure for the Stable Value Fund.

Ms. Henson went on to discuss the overall fund performance, noting the environment in the third quarter of 2014 was a challenging one for active managers. In particular, Wellington's exposure to small- and mid-cap stocks hurt the Opportunistic Growth Fund. The Fixed Income Fund suffered due to PIMCO's underperformance.

Ms. Henson pointed out a chart that showed what the performance would be for participants utilizing GoalMaker. She noted that with regard to conservative funds, GoalMaker is doing well against its peers. Ms. Buonfiglio asked about the peer group, and Ms. Henson replied that it is a target-date, institutional mutual funds group. Mr. Burns asked about the intersection between the retirement readiness numbers and the GoalMaker fund performance. Ms. Buonfiglio noted that for the purpose of calculating retirement readiness a 5 percent rate of return is assumed. Ms. Henson noted that the 6.7 percent return in the most conservative option exceeds this. Mr. Burn said he thinks it would be helpful to have this data on the Dashboard. Ms. Buonfiglio agreed to do so. At this point, Ms. Waller informed the members that the Treasurer would be joining the meeting shortly, and at this time she wanted to point out the National Institute of Public Finance leaflet that had been distributed. Ms. Waller stated that she is working on a curriculum, and a budget is being built for the purpose of bringing financial education to DST employees. A break took place between 11-11:10 a.m.

AGENDA ITEM – STABLE VALUE OPEN ACCOUNTS RECEIVABLE

The Treasurer recognized Ms. Buonfiglio to discuss the accounts receivable accounting error in the Stable Value Fund. This error dates back to 2009 when a portfolio transition took place.

CliftonLarsonAllen has been engaged as the auditor, and will present their full findings in March 2015. The auditor was given specific deliverables, and will present a detailed overview of the events, as well as the impact to the crediting rate and possible fee overcharges to the Plans. She pointed out that there is no loss to the plans due to the error, and the cost of the audit (and any other administrative expenses) will be jointly covered by Prudential, Galliard, and Great West.

AGENDA ITEM – THIRD QUARTER ADMINISTRATIVE REPORT (PRUDENTIAL)

The Treasurer recognized Mr. McCann to present the third quarter performance for the NC 401(k) and NC 457(b) Plans.

Mr. McCann described the sub-goals pursued by Prudential in order to achieve the 2014 retirement readiness goal: that 70 percent of all active NC public servants are on track to replace 80 percent of their pre-retirement income by age 62. Mr. McCann also noted that Prudential is starting to see a demographic change in the Plans. A larger number of people are starting to retire. One thing Prudential has been focusing on is the percentage rate of income participants should be contributing. Currently, it is slightly above 4 percent, and he thinks it perhaps should be 6-7 percent of a participant's salary. Mr. McCann stated the average NC 401(k) balance increase was \$2,200 due to market growth and deferral increases, while the average balance increase in the NC 457(b) Plan was \$500, and this plan also features a smaller number of participants. In the third quarter, 4,500 participants enrolled in the NC 401(k) Plan, and there was a drop in those who elected a deferral decrease. Mr. Orr asked if the events were related to the market conditions, and Mr. McCann responded that one possible reason was that there was the first salary increase in a fairly long time; however, Prudential will investigate the reasons more closely. Mr. McCann shared an enrollment success story: Prudential delivered a two-day robust enrollment program to the employees of the Central Prison of Raleigh, and 171 new participants signed up.

Mr. McCann stated that Prudential has made asset allocation the primary objective. They have as a goal to increase assets in GoalMaker by \$3.2 billion, or 35-42 percent, in the NC 401(k) Plan. With regard to loans and distributions, Mr. McCann confirmed there was very little new loan activity and the distributions were up 15 percent compared to last year. Participants were choosing 25 percent more lump sum distributions compared to last year. This is likely driven by the change in demographics, and presents an educational opportunity to reiterate the advantages of the Transfer Benefit program.

Mr. Lewis left the meeting at 11:30 a.m.

Mr. Hamilton mentioned the FINRA requirement for brokers to explain to clients the justification and impact of rollovers. Ms. Baran noted that if the depiction of fees was reflected in dollars and not just percentages, this could possibly have a big impact on the overall rollovers out of the plans. Mr. McCann agreed, and said Prudential could perhaps put together a fee chart for participants considering a rollover so they could take it to their brokers for comparison Mr.

Orr asked if there was a way to reach members already in an established broker-client relationship, and Mr. Toole reiterated that the plans need to be more strategic and proactive in their approach, business partners need to be leveraged, and the retirement glide path should be adjusted, which as of now, only goes up to retirement and not beyond it. Mr. Toole added that once this goal is achieved, we will be able to market more effectively and raise awareness by providing appropriate resources. Mr. Orr also noted with regards to the large lump sum distributions, this may have a negative impact on overall plan assets.

Mr. McCann continued on to discuss three new organizations to join the NC 401(k) Plan: Neuse Charter School, Smithfield Housing Authority, and Western Piedmont Council of Governments. He also gave a brief overview of changes in employer funding. The Treasurer inquired whether Prudential can assist charter schools in opting into the state retirement system. Mr. McCann replied that Prudential is partnering with Vicki Roberts with regard to educational services to accurately inform employees about both the pension and defined contribution benefits. Mr. McCann thanked Mr. Gray for participating in the latest Signature newsletter “Board Member Spotlight” article.

Ms. Baran inquired about aiding participants in retirement readiness by providing counseling by licensed Certified Financial Planners. The Treasurer also added that participants should be educated on what questions to ask when in retirement. Mr. Toole stated that new branding has been developed for the Supplemental Retirement Plans, and the use of the new brand for all retirement benefits is being discussed. Pension counselors are available to the members on the pension side, and space will be provided for Prudential and TIAA-CREF advisors in the new DST building to deliver one-on-one counseling sessions.

Mr. Stell inquired about the moving date, and the Treasurer said the move will take place no sooner than March 2015, with staggered moves commencing in the spring of 2015. Board meetings will continue to be held in the Caswell building until further notice. *Subsequently, the board was notified of a change in location for the March, 2015 board meeting.*

AGENDA ITEM – REQUEST FOR PROPOSAL FOR UNBUNDLING PROJECT

Mr. Toole reminded everyone that we are in the quiet period due to the ongoing recordkeeper and communications Request for Proposal process. Unbundling will allow for better management of the plans. Three strong proposals were received for the recordkeeper/communication vendor. Board representation will be needed after the initial scoring of proposals, and there is an option of vendor site visits. The full presentation on the recordkeeper/communications RFP will take place in March 2015. The bids for trustee/custodian are due on December 16, 2014, and Mercer will conduct the analysis. The finalist presentations for the custodian will be in January 2015.

AGENDA ITEM – QEBA 403(b) LOAN

Ms. Buonfiglio gave a brief update on the QEBA (Qualified Excess Benefit Arrangement) loan taken out to pay some expenses of the NC 403(b) Program implementation. The \$150,000 loan was requested from the QEBA, and both boards have approved it at a 7.25 percent interest rate. The repayment of the loan will commence once the NC 403(b) administrative account balance reaches \$250,000. No action is required from the board on this item.

AGENDA ITEM –THIRD QUARTER ADMININISTRATIVE REPORT (TIAA-CREF)

The Treasurer recognized Mr. Bruce Corcoran and Mr. James Summerlin from TIAA-CREF to present the NC 403(b) Program update.

Mr. Summerlin advised that (as of October 31, 2014), 33 school districts have signed up for the NC 403(b) Program: three of the districts decided to retain TIAA-CREF as the sole recordkeeper, while nine districts will allow new enrollees to only utilize the NC 403(b). We have acquired seven of the top 10 largest districts in terms of eligible candidate pool size. The latest update regarding assets under management (as of December 10, 2014), was approximately \$700,000. The total number of enrolled participants is 529:82 percent are female and the median age is 44. Twenty-two seminars and 136 counseling sessions were conducted for participants across the state. The contribution goal of \$140 per month was exceeded; the current rate is \$160. It is TIAA-CREF's opinion that the importance of asset allocation is best explained during counseling sessions, and 1,500 of them will be conducted by the end of 2015. Mr. Summerlin reiterated that the sign up goal by the end of 2014 is 50 districts total, and TIAA-CREF staff are working hard to achieve this goal. In addition, the 2015 Marketing Plan will be delivered in January 2015, and the Program will be included in the 2015 Annual Benefits Statement.

Ms. Buonfiglio added that Buncombe County School District has just signed up for the program, and Mr. Summerlin noted that this is the seventh largest district in the state. Mr. Toole commended TIAA-CREF on the microsite development. The Treasurer also expressed her appreciation, stating that both TIAA-CREF and Prudential are working hard to get participants enrolled in high-quality products.

AGENDA ITEM – BOARD QUESTIONS/COMMENTS

The Treasurer reminded members that the next board meeting will take place on March 19, 2015. There were no additional questions or comments.

AGENDA ITEM – PUBLIC COMMENTS

No public comments were offered.

The motion to adjourn was made by Mr. Hamilton and seconded by Mr. Burns. The motion passed unanimously, and the meeting adjourned at 12:04 p.m.

SECRETARY